NEWSLETTER 11th november 2006 http://japoninvestissements.free.fr

Value strategy finally paid off with (7202) Isuzu motor (see 'what to buy ?' section)

The shift toward large international blue chips is still under way as bank stocks are sold. (8306) Mitsubishi UFJ financial group registered a 6 months low the 8th of November. These reflect uncertainties on the economic outlook. Between September end up to the 8th of November looking at the 63 industrial sectors indexes average 24 sectors went down meanwhile Nikkei 225 was registering a small advance. The largest falls were registered by sectors bought in august, generally speaking domestic sectors such as banks, retail, construction or securities have been under selling pressure. Profit taking led the way as advance indicators (plus second half downside revisions) show concern about economic outcome.

Speaking about Japanese banks Mizuho financial group made a slow start for its NY ADR listing. Having finally repaid all the public funds by summer end ADR listing sounds like a symbolic revival. It remains to be seen if Japanese large mega banks can regain worldwide financial marketplace status. Japanese mega banks recovered domestically but net earnings represent a mere 1/15th of US global investment banks net profit and 1/10th of European investment banks profit. By scale and capitalization they rank world leaders but going down to profitability long is the road. The Japanese mega banks true value recovery starts now.

Regarding individual's consumption Japan department stores association (existing stores) will soon publish sales for October. Figure is widely expected to be flat compared to last year. Even if October sales show little growth (or even a slight decrease compared to same month last year) it is important to remember that households income has greatly improved therefore core impact should be felt from calendar 2007. This does mean that opportunities for retail will materialize in the next 2 months or so.

Murakami second death (and resurrection ?)

Double-Sayonara to Japanese activist historic fund. Japanese financial press reported that ex Murakami fund balance, already no less than one tenth of its original net asset value, would fully be given back to subscribers. In fact Yoshiaki Murakami himself who is currently Singapore based has no decision right regarding the dissolution of his fund. With tacit approval of core subscribers holdings had more or less all been sold and entrusted pension money given back to subscribing companies. Murakami fund balance is probably no more than a few billions Yen left I recall that Murakami Fund was set up back in 1999 with university fellows targeting stocks priced at a discount relative to book value. Murakami opened the way as the first Japanese activist putting pressure on cash rich poorly managed companies to rise dividend and reform management. He finally pleaded to guilty to dubious 'insider case' charges but the official Judiciary will take place beginning of calendar 07 and will be closely watched by market participants. Anyway foreign activists swiftly replaced him. Soon new 'Japan made' activist funds will emerge.

Now what to buy ?

Previous value picks update :

(7202) Isuzu motor was included in the PEDY list I published in my newsletter dated 24th June, obviously this choice is now paying off: the 7Th of November (7203) Toyota motor announced they would take 5,9 % of Isuzu capital to develop together low fuel consumption diesel engines. Last April Isuzu cancelled agreement with US GM. Toyota's related (7205)Hino Motor (see my newsletter dated 3rd November 06) and Isuzu immediately entered discussion to link businesses. Japanese auto industrial sector has entered a new phase. Toyota will take 6 million stocks from Isuzu core shareholder Mitsubishi corp and additional 4 million stocks from second shareholder C. Itoh. The whole purchase is roughly 44 billion Yen. If all Isuzu institutional shareholders convert their Isuzu preferred shares into standard shares then Mitsubishi corp and C.Itoh participations are respectively 9,2 and 7,7 %. Toyota and Isuzu will cooperate widely into promising research fields like gasoline substitution fuels (Ethanol?) aiming at Isuzu supplying engines for Toyota European and US sales. It is worth remembering that last year Toyota had already bough GM's Fuji Heavy holding becoming a core shareholder.

In the financial sector my favourite listed Japanese onshore asset manager (8739) Sparx asset management announced impressive earnings for September mid term earnings, net profit increase by + 50 % at 20,9 billion Yen. The Hong Kong subsidiary (specialized in hedge funds) acquired in June started contributing and mutual funds subscription fees are increasing. Interim sales rose + 96 % at 150 billion Yen. Mutual funds balance cumulated subscription fess rose + 69 % at 80,7 billion Yen. By September end entrusted assets balance rose + 49 % at 1 trillion 820 billion Yen. This said due to large September cancellations by foreign investors entrusted asset balance substantially decreased since its august peak, October end assets balance is therefore down 3 % compared to September at 1 trillion 770 billion Yen. Still I believe Sparx is not correctly valued.

On the mid caps M&A front

Here we go again! Japanese white knight vs. foreign activist shareholder. Nikkei dated 10th November reports that Nissin Food started discussions with (2900) Myojo food (see my newsletter dated 27th October) to defend against SPJS TOB offer. It is highly probable that Myojo foods will explore the possibility of (2897) Nissin food becoming a core shareholder. In such a case Nissin must become a shareholder above 700 Yen TOB price. Myojo food other core shareholders include Ryoshoku with 4,5 %, Mitsubishi corp. with 2,4 %. Nissin will have to buy stocks from them to block the TOB offer. Since October ends numerous buyout funds approached Myojo to support counter bid however the company favours same sector stable new core shareholder (from a management perspective it does make sense). Industrial logic beneath: Nissin food already have an 'instant noodle' 40 % domestic market share and could effectively rise domestic market share to 50 % and more. Food makers raw materials (wheat) price has been trending up therefore this would also create scale economies merit unfortunately such a high market share bumps into anti monopolistic legislation.
I recall my readers that HHS methodology (briefly described in my newsletter dated 6th September) clearly showed that food sector was one of the industrial sectors targeted for concentration (hence M&A operations)*. You and I must only look at it from the shareholder's point of view, what is the best combination to support my shareholder's interests?

* sectors open for concentration based on HHI and current profitability.

Industrial sector	Companies number	HHI	Current profitability (%)	Sector leader
Electronics wholesale	89	240	2.7	Daiwabo system
Mid size builders	54	420	2.0	Haseko corp
Electrical engineering	49	532	2.7	Kinden corp
Textile trading	46	558	4.3	Onward kashiyama
Other builders	49	636	2.8	JGC corp
Road works	39	644	1.5	Nippo corp
Auto spare parts	61	705	5.0	Aisin seiki
Other tradings	98	806	3.0	Softbank
Food trading	39	865	1.0	Ryoshoku
Fine chemicals	38	955	4.9	Shin etsu chem

Source : Nomura Securities Financial economy research institute. HHI & current profitability figures are fiscal 2006 based. Current profitability = current earnings /sales

A word to the wise is enough !

Pascal Jeannenot